

Retirees, Check Your Withholding

It may need to be adjusted due to the 2017 federal tax reforms.

Provided by Charles D. Vercellone, ChFC

The Internal Revenue Service has a message for you. You may need to adjust the amount withheld from your paycheck or the size of your estimated tax payments because the agency is using new withholding tables this year. Should you underpay your taxes for 2018, you could be hit with a tax penalty in 2019.¹

If you are retired or about to retire, you should take note of this announcement. While it may seem aimed at salaried employees and small business owners, the changes to the withholding tables also impact you.

Many retirees work in the gig economy. They walk dogs, drive for ridesharing companies, serve as home health aides, and act as management, marketing, legal, and health care consultants. The common thread here is self-employment. Self-employment means making estimated tax payments. This is a new experience for some baby boomers.²

If you have started freelancing or started a part-time business, you must join their ranks. You must file like a business owner even if you have an informal business venture that has lost money; if there is a profit motive, the I.R.S. considers that self-employment.^{2,3}

Double-check your withholding even if you do not work part time. Paying estimated taxes is normal after you retire, whether you work or not; an employer no longer files a Form W-4 for you. Your retirement income probably comes from multiple sources and includes Social Security benefits, mandatory annual retirement account withdrawals, and maybe pension income from a past employer or a pension-like income arranged through a private contract.⁴

Part of your Social Security income can be subject to federal income taxes if your “combined income” exceeds a certain level. “Combined income” = adjusted gross income + non-taxable interest + 50% of your Social Security benefits. If you are single and your combined income falls between \$25,000-\$34,000, you may see up to 50% of your benefits taxed; the limit is 85% when your combined income tops \$34,000. If you and your spouse file jointly and have a combined income between \$32,000-\$44,000, as much as 50% of your benefits may be taxable; above \$44,000, the ceiling is 85%. Some states also tax Social Security benefits.^{4,5}

Given all this, Form W-4V may be handy. You can file it to withhold a flat percentage from each Social Security payment: 7%, 10%, 12%, or even 22%.^{4,5}

Do you receive a pension or pension-style income? Then you may want to file Form W-4P, which withholds taxes from those payments (you can indicate the number of allowances you wish to claim; the more you claim, the less money you withhold).⁴

Regarding the Required Minimum Distributions (RMDs) you must take annually from traditional IRAs and other qualified retirement accounts after age 70½, you have an interesting option if you are wealthy enough not to need 100% of the money. You can tell the custodian of your IRA (or other retirement account) that you want taxes withheld from the RMD, effectively taking care of the quarterly estimated tax payments you would otherwise make on the RMD amount.⁴

To help with all this, the I.R.S. offers an online withholding calculator. This is a feature of its Paycheck Checkup campaign. You can find it at irs.gov/individuals/irs-withholding-calculator.¹

Be sure to consult a tax professional about your withholding. Fine print may need to be studied. For example, not all income is subject to withholding; some forms of self-employment income, income derived from rental activities, and income from jobs in the sharing economy may be exempt. Have this conversation before 2019 arrives.¹

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Citations.

1 - irs.gov/newsroom/avoid-penalty-for-underpayment-of-taxes-irs-says-check-withholding-make-estimated-payments [9/6/18]

2 - irs.gov/businesses/small-businesses-self-employed/self-employed-individuals-tax-center [12/14/17]

3 - irs.gov/businesses/small-businesses-self-employed/business-activities [4/23/18]

4 - cnbc.com/2018/09/12/the-irs-is-warning-retirees-of-this-impending-surprise-tax.html [9/12/18]

5 - kiplinger.com/article/retirement/T051-C000-S004-retiree-tax-tip-tally-taxes-on-social-security.html [9/5/18]

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